

# MMS Group CLSA Presentation

March 2011

McMillanShakespeareGroup



The McMillan Shakespeare Group of Companies

# CLSA Presentation

*A new, different and more capable organisation is emerging from the combination of the Group Remuneration Services business with the Asset Management business.*

- Company overview and revenue model
- Financial highlights and history
- Group Remuneration Services
- Asset Management
- Strengths, service record and sensitivities
- Growth drivers
- Update and outlook
  
- Appendices

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## Company Overview

- MMS is a unique provider of workplace benefits and vehicle solutions in Australia.
- Fleet management business of Interleasing Australia acquired in April 2010.
- The combined business provides salary packaging administration and integrated fleet management services and has unique competitive strengths.
- Group has two segments:
  - **Group Remuneration Services-** provides administrative services in respect of salary packaging and facilitates the settlement of motor vehicle novated leases for customers, but does not provide financing.
  - **Asset Management-** provides financing and ancillary management services associated with motor vehicles, commercial vehicles and equipment.
- Clients include a variety of state and federal government agencies, hospitals, charities and large private sector organisations.
- Employs around 600 staff, with offices in every state in Australia.
- Services delivered through “a house of brands”.

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## Revenue Model

- Salary packaging administration fees:
  - annuity income stream; paid directly and regularly from employees' salary.
- Interest income.
- Facilitation and procurement fees for assisting with novated lease settlements.
- Net interest margin on financed vehicles.
- Fees for managing customer vehicles.
- Supplier rebates based on transaction volumes e.g. fuel, tyres, maintenance.
- See Appendix for further details.

## Financial highlights 1HFY11

- Consolidated NPAT of \$20.5m.
- NPAT and EPS growth of 83% on PCP.
- Group Remuneration Services NPAT of \$15.0m or 35% growth.
- Asset Management NPAT of \$6.6m.
- Interim dividend of 16 cents per share (10 cents PCP).
- Normalised<sup>(1)</sup> return on equity of 43%.

Note 1: Excludes the retained earnings impact of the profit recognised on acquisition as a result of the business combination of ILA.

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## Financial History

	FY05	FY06	FY07	FY08	FY09	FY10
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Total revenue	35,838	48,721	54,536	66,624	77,259	131,021
Normalised pre tax profit from continuing operations	7,915	15,013	19,079	24,919	28,912	39,904
Normalised NPAT	5,054	11,305	13,237	17,368	20,523	27,905
Normalised Basic EPS (cents)	8.0	17.1	19.8	25.8	30.4	41.2
Dividends declared per share (cents)	3.9	9.5	12.5	16.5	19.0	24.0
Amount franked	100%	100%	100%	100%	100%	100%
Normalised ROE (%)	24%	39%	36%	39%	39%	42%
5 year normalised EPS CAGR						39%

**Normalised numbers exclude the \$17.1m acquisition profit recognised in FY10 as a result of the business combination of ILA.**

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## Group Remuneration Services

### **Group Remuneration Services segment definition:**

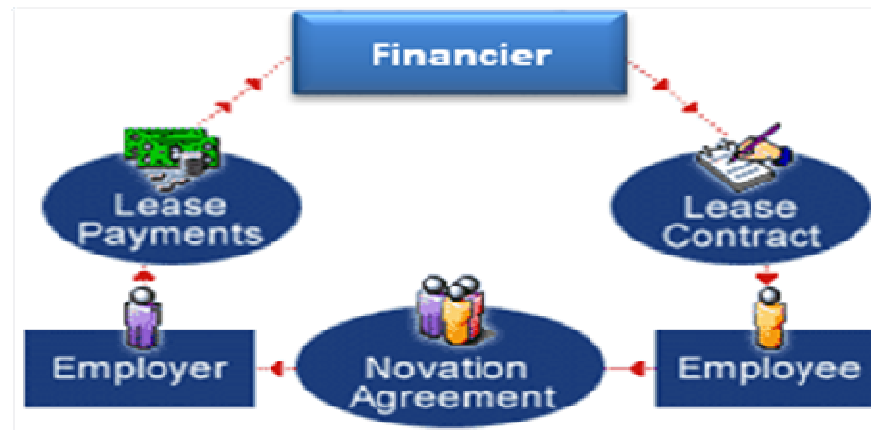
The segment provides administrative services in respect of salary packaging and facilitates the settlement of motor vehicle novated leases for customers, but does not provide financing. The segment also provides ancillary services associated with motor vehicle novated lease products.

## What is salary packaging?

- Australia's taxation system allows tax concessions for certain employee benefits and for certain industry sectors which makes salary packaging attractive.
- Eligible employees increase their disposable income by using pre-tax salary to pay for goods or services.
- Employers use these benefits to attract and retain staff in a tight employment market.
- Payroll systems do not cope well with salary packaging i.e. a bespoke system is required.
- MMS with its knowledge, people and systems, administers budgets; deducts pre-tax salary; makes payments to service providers on behalf of an employee and accurately reports transactions for tax purposes.
- A high transaction load, a complex business process and potential tax liabilities and implications leads many employers to outsource this task.
- MMS has robust and reliable systems, proven DRP and BCP support and the balance sheet to support clients and their employees in times of distress.

## What is a novated lease?

- Enables employees to finance and operate a personal vehicle using their pre-tax income.
- A three way agreement between financier, employee and employer.
- Employee enters into a lease directly with the financier then assigns the obligations of the lease to the employer through a Deed of Novation.
- Employer then pays for lease and operating expenses from employee's income.
- MMS acts as an agent and facilitator – no balance sheet risk/ MMS does not own vehicle.



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## Remuneration Services 1H FY11 Results

	1HFY10	1HFY11	%	Comment
	\$000	\$000	Inc	
<b>Segment revenue</b>	43,098	53,618	24%	
Employee expenses	18,612	20,775	12%	Significantly below revenue growth.
Depn and amort of PPE and software	873	1,537	76%	Reflects recent investment in IT, CRM, BCP/DRP and premises.
Property expenses	1,047	1,936	85%	Additional space and new premises.
Other expenses	6,703	7,875	17%	Significantly below revenue growth.
<b>Total expenses</b>	<u>27,235</u>	<u>32,123</u>	18%	
	<u>15,863</u>	<u>21,495</u>	36%	
Tax	<u>4,770</u>	<u>6,473</u>		
<b>Net profit after tax</b>	<u>11,093</u>	<u>15,022</u>	35%	

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# Asset Management

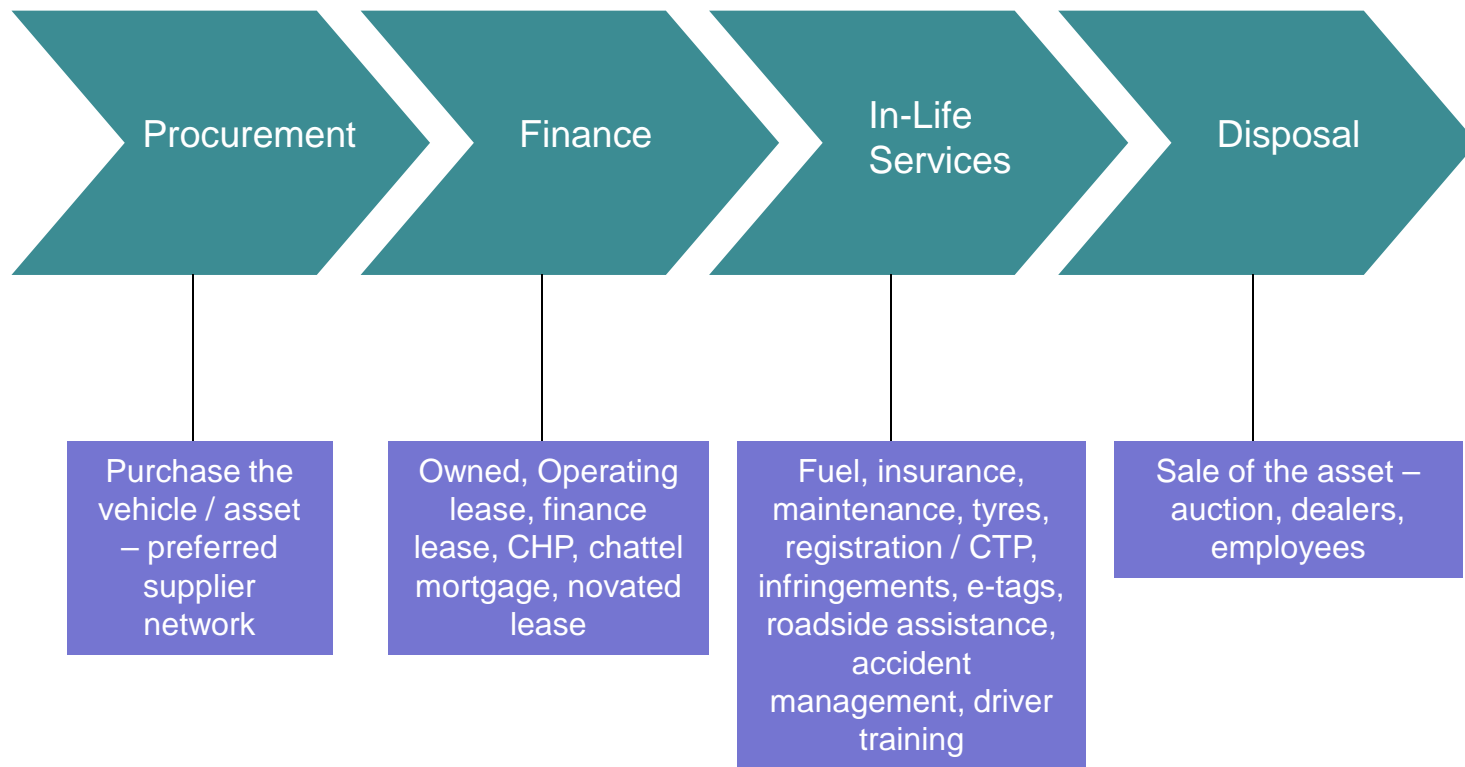
## **Asset Management segment definition:**

The segment provides financing and ancillary management services associated with motor vehicles, commercial vehicles and equipment.

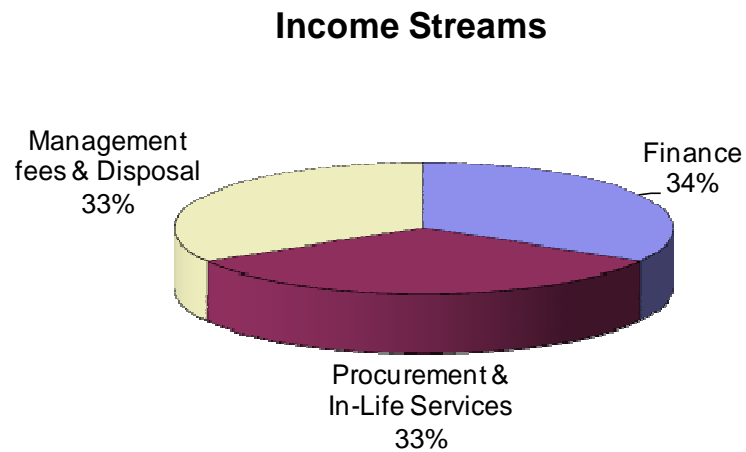
# Asset Management

- Financing and management services associated with motor vehicles, commercial vehicles and equipment.
- A financier can provide funding but this ignores the management of the asset during its life.
- Fleet Management Organisations (FMOs) bring funding and management together; from purchasing an asset, managing it operationally and finally disposal.
- FMOs also deliver to the customer:
  - Knowledge via its experienced staff
  - Systems to manage and report
  - Buying power
- Many major corporates regard asset management as non-core business.

# The Asset Life Cycle



# Income Streams



Income streams – more than interest margin!

- Finance – brokerage / interest margin.
- Management fees and disposal income.
- Procurement and In-life services – commissions, rebates, maintenance and tyre margins.

Asset Management earns income across diverse areas, reducing reliance on one primary income source. Targeting a one-third split in each category group is a general aim of Asset Managers.

## Managing Residual Value Risk

- Residual Values are set for term and kilometres by a Residual Value Committee.
- Proactive contract re-writes are undertaken to mark-to-market residual values where vehicle usage varies to that at inception e.g. kilometre driven; fair wear and tear.
- A portfolio revaluation is performed to assess the future value of operating leases in the light of macro / micro economic conditions – taxes, fuel, employment, GDP, new vehicle volumes, model changes.
- Where appropriate, provisions are taken up.

## Asset Management financial performance

	1HFY11 \$000
<b>Segment revenue</b>	82,683
Depreciation of motor vehicle fleet	32,079
Interest on fleet financing	5,032
Motor vehicle fleet expenses	28,291
Employee expenses	6,197
Other expenses	1,610
<b>Total expenses</b>	<u>73,209</u>
	<u>9,474</u>
Tax	<u>2,868</u>
<b>Net profit after tax</b>	<u><u>6,606</u></u>

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# Strengths, Service Record and Sensitivities

## What are MMS' comparative/competitive strengths?

- A unique market position: the only integrated provider of salary packaging and “one vehicle provider” solutions for both employers and employees.
- Industry leading service levels.
- Scale in BPO business/dominant player (MMS is over twice the size of its nearest remuneration services competitor - lower delivered cost).
- Proprietary, scalable salary packaging IT systems. Difficult and costly to replicate. Reliable DRP and BCP assets and strong balance sheet.

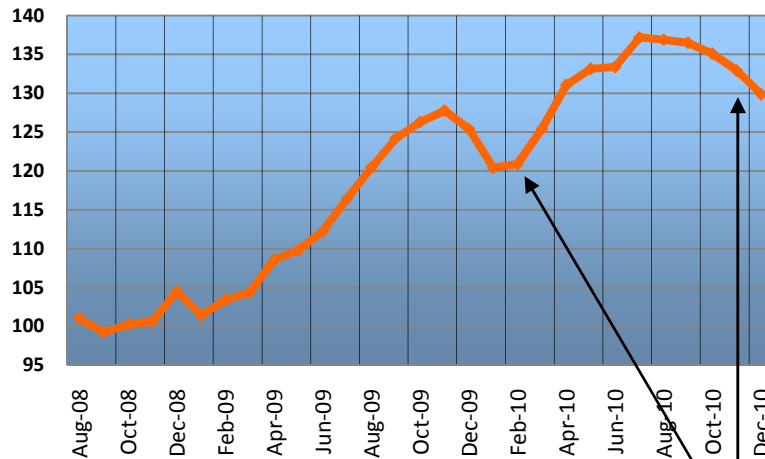
## Our unique market position



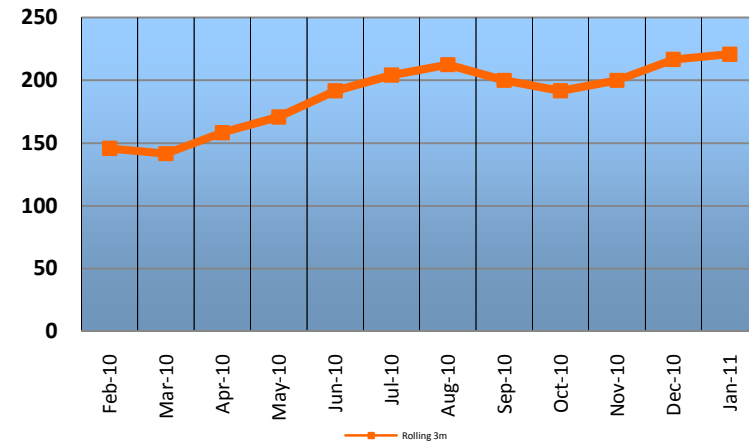
- Ability to offer clients a “one car” solution (operating, novated and managed leases and Fringe Benefits Tax management).
- Novated leases require salary packing AND operating lease skill sets because they involve the purchase and financing of motor vehicles AND Fringe Benefits Tax management and administration.
- Many customers prefer to deal with one supplier.
- Cross selling opportunities.

# Productivity and customer satisfaction indices

**Group Remuneration Services Productivity Index (7/08 = 100)**  
[Rolling 3 month Revenue (ex SP Interest) / FTE]



**MMS Customer Satisfaction Index**  
December 2008 = 100



Increased head count to maintain client service levels during the end of FBT year process.

## Sensitivities

- Queensland flood impact not material (current estimated pre-tax loss to business of \$1m). Around \$0.3m of this insured, subject to “flood” definition.
- Queensland economy post floods/cyclone.
- New car sales.
- Second hand car values.
- Interest rates.
- Key contract tenders.

# Growth Drivers

## Growth opportunities

Salary Packaging	Synergies	Asset Management
<ul style="list-style-type: none"> <li>▪ Increase salary packages through higher penetration rate and new client wins.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Cross-sell salary packaging and novated leases to ILA client base.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Grow the loan book over time with operating and managed leases.</li> </ul>
<ul style="list-style-type: none"> <li>▪ Provide broader workplace benefits to clients' employees.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Cross-sell operating and managed leases to salary packaging client base.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Grow in-life car services, reduce maintenance costs and manage the vehicle value chain.</li> </ul>
<ul style="list-style-type: none"> <li>▪ Increase procurement, supply and financing of cars under novated leases.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Deployment of purchasing power to generate greater procurement discounts and distribution fees.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Management of residual, credit and interest rate risk.</li> </ul>

## Why is the novated lease market growing?

- Relatively young <20 year old.
- In the majority of cases a novated lease provides a more cost effective outcome than using post tax income.
- Allows vehicle to be purchased without the payment of Goods And Services Tax (GST). Effectively discounts purchase price by 1/11<sup>th</sup> .
- GST credits on operating expenses are passed back to employees.
- Delivers discounts on purchase and operating expenses to individuals that are normally available to large fleets.
- Seen by Human Resource practitioners as a vital offering in their employee attraction and retention strategies.
- Complex and time consuming for employers to manage therefore generally outsourced to specialists.

# Update and Outlook

# 1HFY11 key activities and highlights

Focus on integration, maintaining momentum in our core business and the disciplined prioritisation of tasks and opportunities / making choices / not trying to do everything at once.

## Integration

- Other than upgrade of Interleasing IT systems, integration activities will be largely complete by end Q3FY11.
- The combined business is settling into its rhythm.
- New business wins and cross sells continue to build momentum.
- Asset Management capability has opened up significant new opportunity in the private sector for Group Remuneration Services; a largely untapped market for MMS.
- Asset Management has also been successfully sold into Group Remuneration Services clients.

## 1HFY11 key activities and highlights (cont'd)

- Disaster Recovery (DR) and Business Continuity plans (BCP) successfully deployed in QLD floods:
  - RemServ operated successfully for two weeks outside its premises.
  - All salary packaging payments made; RemServ floated funds from its own reserves to cover mortgage and other payments for employees whose employers could not remit funds due to the floods.
  - Vivid demonstration to customers of the benefits of a comprehensive DR/BCP process.
- No significant customer contract losses.
- ILA (despite steep run-off curve when acquired in April 2010), now moving into growth.
- Ongoing industrialisation of our business (better product and service delivery at lower cost) through ongoing investment in:
  - IT and Business Systems.
  - People (recruitment, training, learning and development).
  - Marketing and brand development to create differentiation and ultimately, “franchise” brands.

## Outlook

- Continued, disciplined development of our core businesses. Industrial strength BPO.
- Ongoing growth through:
  - New business and cross-sell from our stronger post acquisition value proposition.
  - Increasing participation rates within existing customer portfolio.
  - Competitive cost of funds and flexible financing facilities.
- Maintain industry leading service levels.
- Look for continuing productivity improvement.
- Continue to invest ahead of the growth curve.

**A new, different and more capable organisation is emerging from the combination of the Group Remuneration Services business with the Asset Management business.**

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## CLSA Presentation Appendices

- Sources of revenue.
- Market opportunity.
- Summary balance sheet and gearing.
- Funding.
- 1H FY11 Cash flow.

## Sources of revenue

Salary Packaging (including motor vehicles)	Novated Lease Management	Novated Lease Distribution Fees	Operating Leases	Management Services
<ul style="list-style-type: none"> <li>Recurring income. Portion of employee's pre-tax salary is transferred to funds held in trust, usually on a fortnightly basis.</li> </ul>	<ul style="list-style-type: none"> <li>Recurring income.</li> </ul>	<ul style="list-style-type: none"> <li>MMS can procure and supply car and after market parts and arrange finance for the employee.</li> </ul>	<ul style="list-style-type: none"> <li>ILA rents passenger and commercial vehicle fleets typically to corporate customers.</li> </ul>	<ul style="list-style-type: none"> <li>ILA receives administration fees for managing client owned car fleets i.e. Corporates.</li> </ul>
<ul style="list-style-type: none"> <li>Disbursements made on behalf of employees from funds held in trust account.</li> </ul>	<ul style="list-style-type: none"> <li>Employee pays for lease administration. Paid out of pre-tax salary.</li> </ul>	<ul style="list-style-type: none"> <li>Success based distribution fees are paid by the financier and/or suppliers.</li> </ul>	<ul style="list-style-type: none"> <li>Typically a three year lease term.</li> </ul>	<ul style="list-style-type: none"> <li>Services include arranging toll fees, repairs, fuel, insurance and scheduled maintenance.</li> </ul>
<ul style="list-style-type: none"> <li>MMS earns an annual management fee paid typically in fortnightly instalments.</li> </ul>	<ul style="list-style-type: none"> <li>Typically a four year lease period.</li> </ul>	<ul style="list-style-type: none"> <li>One-off fees i.e. Unlike administration fees, not recurring income.</li> </ul>	<ul style="list-style-type: none"> <li>ILA retains ownership of the vehicles (appears on the ILA balance sheet as a fixed asset).</li> </ul>	<ul style="list-style-type: none"> <li>Agency business with low levels of capital employed.</li> </ul>
<ul style="list-style-type: none"> <li>MMS typically has a 5 year contract with the employer on a 3+1+1 basis.</li> </ul>	<ul style="list-style-type: none"> <li>Employee is the beneficial owner of the car.</li> </ul>		<ul style="list-style-type: none"> <li>Recurring rental income covers interest costs, depreciation/principal repayments, in-life car services e.g. Fuel, tolls, tyres, green slips, infringements and management fees.</li> </ul>	
<ul style="list-style-type: none"> <li>Customer base includes over 800 charities, NFP's, public health, government departments and corporates.</li> </ul>			<ul style="list-style-type: none"> <li>Cars sold at lease expiry using retail and wholesale channels.</li> </ul>	

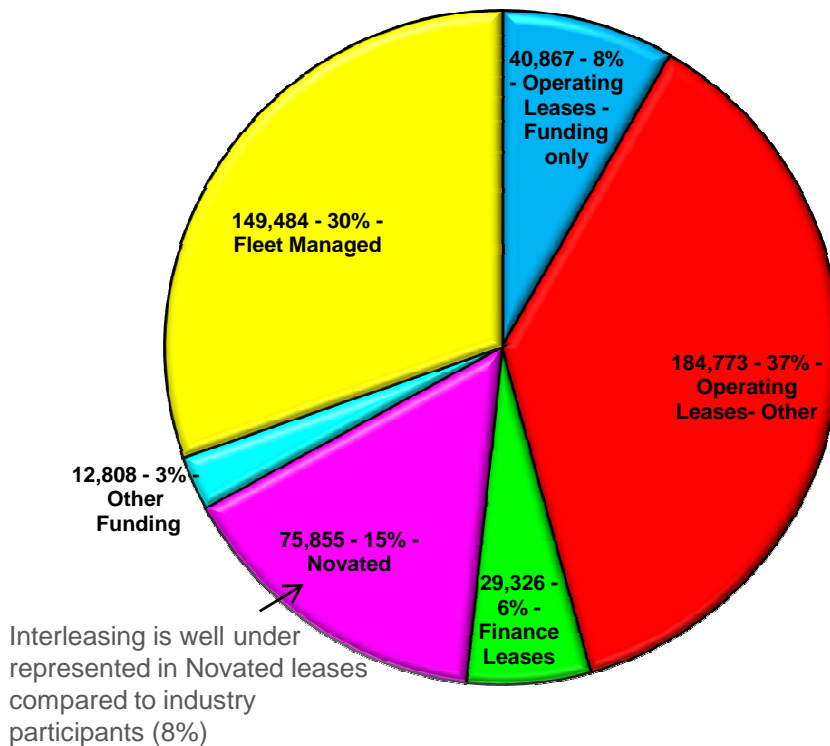
# Market opportunity

	Full FBT	Rebatable FBT	\$17,000 Exempt	\$30,000 Exempt
<b>Types of Employers</b>	Government departments. Private companies. Public companies.	Independent schools. Sporting clubs. Religious institutions. Trade unions.	Public hospitals. Private not-for-profit hospitals.	Public benevolent institutions. Charities.
<b>FBT Treatment</b>	FBT rate 46.5% on taxable value of benefits.  Certain benefits, including motor vehicles on novated leases are concessionally taxed.	Rebatable FBT on first \$30,000 of grossed-up taxable value of benefits (46.5% rebate). Equates to \$16,050 of benefits concessionally taxed. Full FBT on excess over \$30,000.	FBT exempt on first \$17,000 of grossed-up taxable value of benefits. Equates to \$9,095 of benefits.  Full FBT on excess over \$17,000.	FBT exempt on first \$30,000 of grossed-up taxable value of benefits. Equates to \$16,050 of benefits. Full FBT on excess over \$30,000.
<b>Common Fringe Benefits</b>	Novated leases. Associate leases. Additional superannuation. Professional association membership fees. Living away from home allowance. Remote area housing allowance.	Novated leases. Additional superannuation. Mortgage/rent. In-house school fees.	Additional superannuation. Mortgage/rent. Meal entertainment and venue hire. Personal loans. Living expenses. Novated leases (not part of cap).	Additional superannuation. Mortgage/rent. Meal entertainment and venue hire. Personal loans. Living expenses. Novated leases (not part of cap).
<b>Total workforce</b>	10.7m			
<b>By sector</b>	9.5m		1.2m	
<b>MMS target market</b>	2.5m		1.0m	
<b>Typical participation</b>	0-20%		59-90%	
<b>Target participation</b>	5-25%		80-90%	
<b>Estimated outsourced participants</b>	0.45m			
<b>Conclusion</b>	Large untapped market to exploit			

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## Market opportunity (cont'd)

Australian Fleet Lessors Association (AFLA) -  
Total Portfolio at July 2010 By Type of Facility  
(units/%)



- ILA is a tier 2 industry player.
- ILA share of novated leases as % of total fleet significantly less than AFLA average.
- MMS's expertise in novated lease allows MMS to target even greater % novated lease share.
- Access to capital and significant flexibility in pursuing optimum funding structure.
- CAGR for 2001-2009 was 8% (AFLA). Expect 5-8% over next 5 years.

## Gearing

	<b>MMS and Group Remuneration Services <sup>(1)</sup></b>	<b>Asset Management</b>	<b>Group Balance at</b>	<b>Group Balance at</b>
	<b>31st Dec 2010</b>	<b>31st Dec 2010</b>	<b>31st Dec 2010</b>	<b>30th Jun 2010</b>
	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>
Net debt	14,457	105,227	119,684	125,970
Book value of equity	11,983	89,628	101,611	89,417
Gearing - net debt / (net debt + equity)	55%	54%	54%	58%
Interest times cover			5.70	5.80

**(1) Includes net debt of MMS for the acquisition of ILA**

As at 31st December 2010 the group remains well within its banking covenants, while better utilising surplus working capital. Significant headroom is available within debt facilities to deliver on business plan.

## Asset Management key balance sheet numbers

	31st Dec 2010	30th June 2010
	\$000	\$000
Operating lease assets	204,672	202,471
Finance leases	8,679	9,226
Fleet financing borrowings	108,000	112,727
Maintenance instalments received in advance	6,310	8,653
Net assets	89,628	83,022

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## Funding

The Group recently renegotiated its borrowing arrangements for Interleasing. The objectives of the renegotiation were to:

- Provide longer-term funding facilities to enhance liquidity position;
- Reduce funding costs; and
- Provide greater flexibility.

The \$180m ILA facility has:

- been extended by two years to 31 March 2014;
- been repriced to lower the cost; and
- incorporated improved capital management covenants.

The parent company facility of \$30m has been reduced to \$26m following the first six monthly repayment of \$4m during 1HFY11. The expiry date of 31 March 2013 for this facility remains unchanged. Our alternative funding initiatives are developing in accordance with our funding strategy.

# 1HFY11 cash flow

	Group Remuneration Services \$000	Asset Management \$000	Unallocated/ MMS \$000	MMS Group Total \$000
<b>Segment NPAT</b>	15,022	6,606	(1,102)	20,526
Non-cash (non-fleet depreciation and fleet provision movements)	1,537	(1,314)	-	223
Working capital inflow/(outflow)	1,578	534	-	2,112
	<u>18,137</u>	<u>5,826</u>	<u>(1,102)</u>	<u>22,861</u>
Tax payments in excess of tax expense	(1,617)	(1,645)	-	(3,262)
<b>Net operating cashflow before fleet increase</b>	16,520	4,181	(1,102)	19,599
<i>Investing activities and fleet increase:</i>				
Net growth in operating lease portfolio funded with cash	-	(2,200)	-	(2,200)
Acquisition costs	-	-	(340)	(340)
Capex (non-fleet) and systems	(2,929)	(12)	-	(2,941)
<b>Free cash flow</b>	13,591	1,969	(1,442)	14,118
<i>Financing activities:</i>				
Equity contribution	1,057	-	-	1,057
Intercompany funding	(2,400)	2,400	-	-
Debt repayments	(4,000)	(4,727)	-	(8,727)
Dividends paid	(9,497)	-	-	(9,497)
	<u>(14,840)</u>	<u>(2,327)</u>	<u>0</u>	<u>(17,167)</u>
<b>Net cash movement</b>	<u>(1,249)</u>	<u>(358)</u>	<u>(1,442)</u>	<u>(3,049)</u>

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